Supreme Court, U.S.
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No. 92-1228

In The
Supreme Court of the United States

October Term, 1992

REPUBLIC NATIONAL BANK,

Petitioner,

v.

AMWEST SURETY INSURANCE COMPANY,

Respondent.

On Petition For Writ Of Certiorari To The United States Court Of Appeals For The Fourth Circuit

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BRIEF OPPOSING PETITION FOR WRIT OF CERTIORARI

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QUESTION PRESENTED

1. Whether the Supreme Court of the United States should grant a writ of certiorari to review a decision of the United States Court of Appeals for the Fourth Circuit in a case brought originally under the federal district court's diversity jurisdiction (28 U.S.C. Section 1332), which determined no federal questions, was based solely upon the substantive law of South Carolina, and involved a commercial dispute of limited scope and impact.

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CONSTITUTIONAL PROVISIONS AND STATUTES INVOLVED

The Petitioner has correctly noted that the opinion of the United States Court of Appeals for the Fourth Circuit in this case involved questions of substantive law arising under the following statutes of the State of South Carolina: Sections 36-5-108(3)(a), 36-5-111(1), and 36-5-114(2)(b). The petitioner has also invoked the Fifth Amendment of the Constitution of the United States. However no federal questions were involved in the controversy decided by the court of appeals. Rather it is apparently Petitioner's contention that the effect of the court of appeal's decision was to deny Petitioner due process under the Fifth Amendment.

STATEMENT OF THE CASE

1. General Statement

This case involved a series of transactions affecting a letter of credit issued by the petitioner under South Carolina law. The letter of credit had been issued for the benefit of Respondent, to protect Respondent from losses which might arise as a result of Respondent's having issued a surety bond naming Petitioner's customer as the principal obligor. In the course of these transactions, Respondent delivered a payment to Petitioner in the amount of $122,000.00, with instructions that the funds be "put back into" the letter of credit. Instead, Petitioner retained the funds. The

net effect of the transactions between Petitioner and Respondent was that Respondent received the benefit of only $38,000.00 in funds which were traceable to the $160,000.00 letter of credit, despite Respondent's having suffered much greater claims against the surety bond. Respondent brought this action against Petitioner under various theories arising under South Carolina law to recover the amount of the payment made by Petitioner to Respondent.

2. Supplement and Response to Petitioner's Statement of Facts

Respondent Amwest Surety Insurance Company (Amwest) was unaware of the existence of a promissory note executed by Amwest's principal B&F Contractors, Inc. (B&F) to Petitioner Republic National Bank (Republic).[1] As a legal matter Amwest was not concerned with Republic's relationship with its customer (which may in fact have been a party other than B&F) with respect to the letter of credit.

Amwest did not act improperly or make any false warranty when it initially submitted a draft for $160,000.00 against the letter of credit. However,

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[1]Respondent Amwest Surety Insurance Company is a subsidiary of Amwest Insurance Group, Inc., which is also the parent of Far West Insurance Company. The shares of all three companies are publicly traded. The parties are accurately named in the style of the petition.

Amwest's election to draw the entire amount of the letter of credit was based in part upon a mistaken belief by one of Amwest's employees that partial draws against the letter of credit were not permitted. When that notion was corrected -- which was almost immediately upon submitting the initial draft -- Amwest promptly attempted to rescind the initial draft, seeking in effect to convert the full draw into a partial one by delivering a check for the difference to Republic with directions that the funds be "put back into" the letter of credit. Apparently on the direction of a third party who was a guarantor of B&F's obligation to Republic, Republic retained the funds delivered by Amwest and refused to re-institute the letter of credit. (Pet. App. 4a-5a.)

SUMMARY OF THE ARGUMENT

The court of appeals injected no new issues into this case in its opinion. The court of appeals' discussion of a "windfall" plainly involved nothing more than the use by the court of a particular term in its discussion of the equities involved in Amwest's claim for restitution. Further, even if the court of appeals' discussion of the statutory warranty pertaining to letters of credit had introduced new matter to the case, Republic had ample opportunity to address that discussion -- and Republic did address it -- in its petition for a rehearing by the court of appeals. Republic's petition for rehearing did not, however,

suggest that Republic had been denied any desired opportunity to introduce additional factual evidence at trial, and no such need is specified (rather than simply alluded to) in Republic's petition for certiorari. Accordingly, Republic has suffered no deprivation of due process. Helis v. Ward, 308 U.S. 365 (1939). Finally, the court of appeals' discussion in its opinion of the statutory warranty pertaining to letters of credit is little more than dicta due to the court's alternative holding that restitution would be awarded Amwest irrespective of any breach of the warranty, and accordingly the decision will have little influence beyond what is due it on the strength of the reasoning that was presented by the court.

ARGUMENT

Republic contends in its petition that it never had the opportunity in this case to argue the issue of whether "Amwest had not warranted the truth of its draw request," or the issue of whether the transactions between Amwest and Republic resulted in a "windfall" to Republic. (Pet. 6.) Yet, the primary issues addressed by both the district court on summary judgment and the court of appeals in the appeal from summary judgment were whether the critical payment by Amwest to Republic had caused Republic to be unjustly enriched so as to support a claim for restitution, whether Amwest had breached a statutory warranty (under S.C. Code Ann. Section 36-5-111(1)

(1977)), and if so, whether such a breach would preclude Amwest from recovering. These are essentially the same matters of which Petitioner now complains.

From the first pleading in this litigation, Amwest has consistently argued that the effect of Amwest's payment to Republic, in the context of the various transactions relating to the letter of credit, was to unjustly enrich Republic. Republic opposed Amwest's position, arguing in its motion for summary judgment--as it continues to do now in its petition for review by this court -- that Amwest breached a statutory warranty pertaining to drafts against a letter of credit, and that therefore Amwest did not "own" the funds which Amwest delivered to Republic, and that therefore Republic could not have been unjustly enriched by retaining those funds. Republic's argument was accepted by the district court in its order on summary judgment. Republic's argument was rejected by the court of appeals, which found that Amwest should recover its payment to Republic regardless of whether Amwest had breached the statutory warranty.

The court of appeals' conclusion that Amwest should recover from Republic was based upon sound principles of the law of restitution, referred to as such in the court of appeals' opinion. Amwest's claim for restitution was based upon principles of South Carolina common law which recognizes an action for the recovery of money which, "in equity and good

conscience belongs to [the plaintiff]...." McDonald's Corporation v. Moore, 237 F.Supp. 874, 877 (W.D. S.C. 1965); and see, also, U.S. Rubber Products v. Town of Batesburg, 183 S.C. 49, 190 S.E. 120 (1936), and Am.Jur. 2d Restitution, at Section 3 (1985). In conducting its analysis of Amwest's claim, the court of appeals quite appropriately considered the overall effect of the transactions between Amwest and Republic, which the court correctly concluded had resulted in an inequitable advantage to Republic and an unfair detriment to Amwest. The court of appeals referred to this advantage and corresponding detriment as a "windfall."

Republic now claims that the use of this innocuous and generic term means that the court of appeals' decision was based upon an entirely new theory or "doctrine" not previously addressed in these proceedings. (Pet. 5.) It was not. There simply is no "doctrine of windfall" existing independently of the legal and equitable principles which have always been at issue in this case. A windfall, according to a popular general dictionary, is "an unexpected or sudden gain or advantage." WEBSTER'S THIRD NEW INTERNATIONAL DICTIONARY OF THE ENGLISH LANGUAGE UNABRIDGED (Merriam-Webster, 1986, second entry). A correspondingly popular law dictionary does not even carry an entry for the term (though "windfall profits tax" is defined, courtesy of the

1980 Arab oil embargo). BLACK'S LAW DICTIONARY (6th ed. 1990); Cf. Slaughter v. Levine, 801 F.2d 288, 302 (8th Cir. 1986) (granting the equitable remedy of injunction, under general equitable principles, to prevent recoupment by the state of welfare overpayments which the state characterized as a "windfall" to the recipient). In the present case, the court of appeals' use of the word "windfall" to characterize the effect of Amwest's payment to Republic simply did not inject any new issue, legal, equitable or factual, into the proceedings.

Perhaps more importantly, the petitioner's premise that the court of appeals decided this case on a different theory from that considered by the district court, even if it were true, would not require that the petitioner be granted additional review or that the case be remanded for new proceedings. In Helis v. Ward, 308 U.S. 365, 369 (1939), the trial court had applied its interpretation of the contract at issue to evidence which was admitted without objection at trial in arriving at a judgment. On appeal, the circuit court of appeals first arrived at a different interpretation of the contract, then applied its new interpretation to the same evidence which had been considered at trial, and finally reversed the trial court. The aggrieved litigant, relying on Saunders v. Shaw, 244 U.S. 317 (1917), sought review by the Supreme Court on the grounds that he had been deprived of due process as a result

of the court of appeals having decided the merits of the case on a theory which had not been presented at trial. Helis, at 369. The Supreme Court rejected the petitioner's theory and affirmed the decision of the court of appeals.

In its decision in Helis, the Supreme Court held that an appellate court's adoption of a new theory during the appeal of a case does not per se violate the losing party's due process rights. The Supreme Court then observed that the petitioner in that case had not sought a new trial or otherwise shown that he could prove additional facts going to the merits of the case, in either his petition for rehearing by the court of appeals or in his petition for certiorari. Helis, at 369-370 and n.2. Accordingly, the Supreme Court concluded, the court of appeals' decision had not denied to the petitioner any right which had not been waived.

The issues presented in Republic's Petition are controlled by the Supreme Court's holding in Helis. As in Helis, the petition which Republic made for rehearing by the court of appeals (which is set forth in its entirety in the appendix to this brief), sought no opportunity to present additional evidence, but contained instead a lengthy and detailed argument against the legal theories presented by the court of appeals in its opinion (as construed by Republic). Indeed, since moving for summary judgment in the district court, Republic has not significantly departed

from its position that the relevant facts in this case are not disputed and are in the record. The relief ultimately sought in Republic's petition for a rehearing by the court of appeals was not a new trial, but a rehearing in which Republic could "challenge [the appellate panel's] reasoning," which Republic characterized as having "infirmities." (Resp.App. 18(a).) Of course, Republic had already challenged the appellate panel's reasoning in the body of the petition for rehearing, a challenge which the court of appeals duly considered and denied.

In its Petition for Certiorari, Petitioner pays lip service to the notion that the court of appeals, in its opinion in this case, decided novel factual issues in addition to introducing what Republic characterizes as new legal theories. (Petition, 6, 8.) However Petitioner suggests no facts which it might expect to prove at a new trial pertaining to such issues, and more importantly, Petitioner fails to explain how the factual proofs relevant to deciding whether "the retention of the disputed funds by Republic under all of the facts of this case would have been so inequitable as to amount to a windfall" (Pet. 6), might differ from the factual proofs relevant to whether Republic had received a payment of money which, in equity and good conscience, belonged to Amwest. Moreover, in practically the same breath with which it invokes the bare possibility of making new factual proofs, Petitioner urges the Supreme Court to issue a

summary reversal of the court of appeals' decision, and that prayer is repeated in the conclusion of Republic's Petition. (Pet. 8, 14.) Thus, Republic's petition for rehearing to the court of appeals, without exception, and Republic's Petition for Certiorari, in substance, demonstrate clearly that Republic's only argument in this case is that the court of appeals erred in applying the substantive law of the state of South Carolina.

Finally, the decision of the court of appeals in this case will have little impact beyond the actual determination of Amwest's claim against Republic. While the court of appeals' discussion of the statutory warranty pertaining to letters of credit is an interesting contribution to a very small body of jurisprudence, it carries no real weight. Not only does the analysis suffer from being the expression of a federal court sitting in diversity, but, because of the court's alternative holding, the discussion of the warranty statute is ultimately rendered little more than dicta. That the court of appeals' opinion contains such an extended discussion at all is little more than a testimonial to Republic's insistence on shifting the emphasis in this case away from an analysis of the payment which Amwest filed this action to recover. Republic has insisted that if it could show that Amwest breached the statutory warranty, then Amwest could not claim that it owned (and hence, was entitled to control) the funds which Amwest delivered to Republic. Republic still insists on this proposition

(Pet. 12 n.7), but still has not supported it, and the court of appeals properly rejected it. The court of appeals' discussion of the statutory warranty thus is pertinent, but not that important, and in any event presents no grounds for review.

CONCLUSION

This case involves no conflict between one United States court of appeals and another; this case involves no decision by any court of any federal question (let alone one of great importance); and this case involves no departure by the lower court from the usual course of judicial proceedings. (See, generally, Rule 10.1, Rules of the Supreme Court of the United States.) Instead, this petition involves a litigant who is unhappy with a decision by the court of appeals concerning issues of substantive state law, a decision which was rendered only after the issues were extensively briefed and argued to, and considered by, the court of appeals. Moreover the decision of the court of appeals in this case concerns such a peculiar situation, and such a limited issue of law, that it is unlikely ever to have much impact beyond the parties to the present litigation.

This case is not an appropriate case for review on a writ of certiorari, and the petition should be denied.

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APPENDIX

IN THE

UNITED STATES COURT OF APPEALS

FOR THE FOURTH CIRCUIT

Case No. 91-2713

AMWEST SURETY INSURANCE COMPANY,

Appellant,

v.

REPUBLIC NATIONAL BANK,

Appellee.

PETITION FOR REHEARING AND
SUGGESTION FOR REHEARING IN BANC

On Appeal from the United States District Court
for the District of South Carolina, Columbia Division

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Statement of Facts

Republic issued a $160,000.00 stand-by letter of credit to Amwest as security for the obligations of the account debtor, B & F Contractors, Inc., under payment and performance bonds issued by Amwest in connection with B & F's performance of a construction contract. One of the conditions of the letter of credit was that Amwest consider its draw necessary by reason of having issued the bonds, which in effect meant that draws could not exceed the amounts of claims made against the bond. Amwest's first draw request was for the full $160,000.00 although claims made totalled only $38,000.00. Amwest made no determination that a draw in the full amount was necessary. When B & F discovered the draw, it complained to Amwest, which then attempted to change its draw to $38,000.00. Amwest requested the change too late, however, because Republic had immediately honored the initial draw request for $160,000.00, not knowing that Amwest had violated the conditions of the letter of credit. By honoring the draw request, Republic was discharged from further liability on the letter of credit.

Amwest then sent Republic a check for $122,000.00 (the difference between $160,000.00 and $38,000.00) requesting that Republic "put it back into" the letter of credit. Republic declined and instead applied the $122,000.00 to the $160,000.00 indebtedness of B & F which was created when the letter was wrongfully drawn down by Amwest. Amwest then demanded that the $122,000.00 be returned to it, and Republic refused. Amwest thereafter submitted a $122,000,00 draw request which Republic declined to honor on the ground that the

letter of credit was discharged. Amwest made no determination that a draw of $122,000.00 was necessary. Upon dishonor of the last draw, Amwest brought suit to recover the $122,000.00.

Course of Proceedings and Disposition

Amwest filed its Complaint on September 29, 1989, seeking to recover the $122,000.00 which it had returned to Republic. Recovery was sought on the theories of breach of implied contract, breach of express contract, fraud, bad faith and unjust enrichment. The district court dismissed the fraud and bad faith claims by order dated April 23, 1990. Thereafter the parties submitted cross-motions for summary judgment on the remaining claims. By order dated September 30, 1991, the Court granted summary judgment to Republic on all remaining counts and denied Amwest's motion. Final judgment was entered on the Order on October 2, 1991. Amwest appealed from the orders dismissing its fraud claim, granting summary judgment to Republic and denying summary judgment to Amwest. On October 1, 1992, the panel affirmed so much of the district court's orders as granted dismissal of the fraud claims and granted summary judgment in favor of Republic on the express and implied contract claims. However, the panel reversed the district court's grant of summary judgment to Republic on the unjust enrichment claim and the denial of summary judgment in favor of Amwest on that claim, and directed the district court to enter summary judgment in favor of Amwest for restitution in the amount of $122,000.00.

Introduction and Statement of Purpose

Republic hereby petitions the Court to rehear this appeal and suggests that rehearing be conducted *en banc*. In the judgment of counsel for Republic, the Court's decision should be reviewed because:

A. The panel reversed the district court upon legal and factual grounds and theories which were not presented by Amwest to the district court and which were not briefed by Amwest before this court, with the result that the panel's decision violates Republic's rights to procedural due process of law as guaranteed by the Fifth Amendment to the United States Constitution. (Page 15 *infra*).

B. In holding that Amwest did not breach the §5-111 warranties of the Uniform Commercial Code, the Court's decision overlooks the fact that a necessary condition to the letter of credit was that the amount of the draw *in fact* equal the amounts of claims actually paid under the bond, and not simply that Amwest represent such equality to exist. (Page 8 *infra*).

C. The Court's decision overlooks the fact that its holding that fraudulent statements made by the beneficiary in satisfaction of the conditions of the letter of credit do not violate §5-111 warranties unless the veracity of those statements has itself been independently warranted in the letter of credit is directly contradicted by other authorities which the Court has overlooked. (Pages 6 to 10 *infra*).

D. The Court's decision overlooks the fact that Republic's position does not involve a dispute on the underlying contract between

Amwest and the account debtor as to the amount actually due between them, but instead involves only the issue under the letter of credit as to whether the amount of the draw exceeded claims actually paid under the bond. (Pages 10 to 12 *infra*).

E. The Court's opinion overlooks relevant authorities which uphold the entitlement of the issuer to the proceeds of a letter of credit when there has been a breach by the beneficiary of the rule 5-111 warranty. (Pages 12 to 14 *infra*).

Grounds for Rehearing En Banc

Republic respectfully suggests that this appeal should be reheard *en banc* because the panel's opinion establishes new standards and establishes new remedies which very probably will have profound effects upon the availability and performance of letters of credit as facilitators of interstate commerce. It matters not that the Court's opinion decides only matters of South Carolina state law. Virtually all issues relating to letters of credit are state law issues. A reading of letter of credit cases reflects, however, that state and federal courts draw freely upon cases from other jurisdictions due to the uniformity of the statutory frameworks involved. That the ramifications of published opinions such as this one can be expected to have far-reaching consequences has been eloquently noted by one federal appellate judge as follows:

> Though the instant case is a diversity case and "writing in diversity we write on the wind," *Thompson v. Johns-Manville Sales Corp.*, 714 F.2d

> 581 at 583 (5th Cir. 1983) (Gee, J.), the precedential force of the majority opinion is likely to be great considering the field of law and the status of the author. It stresses me to think that the once useful device of letters of credit may be a less reliable device now.

Philadelphia Gear Corp. v. Central Bank, 717 F.2d 230, 242 (5th Cir. 1983) (Goldberg, J., dissenting).

Argument and Citation of Authority

In the sections which follow, Republic will set forth the factual and legal shortcomings in the panel's reasoning which support rehearing. Thereafter, Republic will demonstrate that the grounds relied upon were raised for the first time in the panel's opinion and therefore constitute improper bases upon which to reverse the lower court.

I. THE APPLICABILITY AND EFFECT OF THE §5-111 WARRANTIES

The warranty which is provided in §5-111(1) of the Uniform Commercial Code (codified in South Carolina at S.C. Code Ann. §36-5-111(1) (1977)) provides that in presenting a draft a beneficiary warrants "that the necessary conditions to the credit have been complied with." Republic's position at trial and on appeal is that by submitting a draft which exceeded the amount of claims made, Amwest violated one of the necessary conditions of the credit, thereby breaching its warranty that it had satisfied that condition. And since the South Carolina Reporter's Comments to §5-111(1) specifically confirm

"the right of an issuer to recover any payment made to a beneficiary when the conditions of the credit have not been complied with . . . ," Republic takes the position that it, and not Amwest, was entitled to the $122,000.00.

The panel rejected this reasoning on two grounds. First, it recognized a purported split in authority as to whether a beneficiary, in addition to making statements required by the conditions of the letter of credit, also warrants that those statements are true. Finding that there is no warranty of veracity unless expressly set forth in the letter of credit, the panel concluded that Amwest had not violated the §5-111 warranty even though its statements may have been false. As Republic will explain, the panel's decision on this basis establishes a new standard under letter of credit law and conflicts with all other cases to consider the issue.

Second, the panel rejected Republic's warranty argument on the ground that to allow Republic to retain the disputed funds would violate the independence principle, which states that it is improper to determine the obligations of the issuer through reference to performance of the underlying contract between the beneficiary and the account debtor. The Court found the independence principle to be applicable upon the erroneous conclusion that "allowing the issuer to recover funds paid on a draft because of falsity of such assertions amounts to allowing the issuer to recover for non-performance of the underlying contract." Republic will show below that any representation at issue here has nothing to do with the underlying contract but only with respect to the amount of claims paid, with the result that the independence principle is irrelevant.

A. Separate Warranty of Veracity Is Not a Requirement of §5-111(1).

The panel's decision is based primarily on what it perceives to be a split of authorities as to whether or not the beneficiary warrants the truth of statements made by it in order to satisfy the conditions of the letter of credit. Slip Op. at 10. The panel opted to adopt the alleged view that there is no such warranty of veracity unless it appears in writing in the letter of credit.

This ruling, in effect, immunizes fraud by assuring beneficiaries that they have nothing to lose by misrepresenting their performance of conditions or by negligently performing their obligations under the letter of credit. It ignores the fact that any party who is entitled to the protection of §5-111 warranties, to include the account debtor as well as the issuer, is stripped of much of that protection. The account debtor has virtually no other protection under Article 5, and is now relegated to total reliance upon its rights, if any, under the underlying contract. The beneficiary is now free to receive the benefits of early or wrongful collection of sums due, even though such wrongful acquisition of the proceeds of the letter of credit may have harmed the account debtor and even though the beneficiary may have had no contractual right to the proceeds at the time they were obtained.

The panel's holding also endangers important interests of the issuer. In agreeing to issue a letter of credit, an issuer accepts only the risk that the account debtor will default thereby necessitating a draw against the letter of credit. The panel's apparent conclusion that the issuer also knowingly accepts the risks which result when the

beneficiary abuses its rights or neglects its obligations under a letter of credit is certainly contrary to commercial practice, and will doubtlessly make issuers more reluctant to issue letters of credit in the future. Other courts have recognized a strong public interest in preventing deception in connection with letter of credit transactions. *E.g. Universal Marine Insurance Co. v. Beacon Insurance Co.*, 581 F.Supp. 1131, 1139 (W.D.N.C. 1984); *Larson v. First Interstate Bank of Arizona*, 603 F.Supp. 467, 470 (D.Ariz. 1983). The panel's opinion clearly violates that interest.

The panel's decision suffers as well because it is based upon an apparent misunderstanding of the facts. It chooses to view this case for some reason as involving only a *misrepresentation* by Amwest that it deemed the draw necessary. It fails to recognize, however, that Republic claims that it was an actual *condition* of the letter of credit that the draw not exceed claims actually made against the bond. Appellee's Brief at 30-32. This condition was unquestionably not fulfilled by a draw which exceeded claims made by $122,000.00. If such a condition did not in fact exist, the warranty was indisputably broken, whether or not representations were made. Thus, a warranty of veracity is not necessary to a finding of breach of the §5-111 warranties.

Not only is the panel's decision factually infirm, the cases relied upon do not offer strong support for its decision. The intermediate appellate decision in *Delta Brands, Inc. v. MBank Dallas, N.A.*, 719 S.W. 2d 355 (Tx. Ct. App. 1986) does not in any manner limit the warranties available under §5-111. It simply confirms that the beneficiary warrants that documents are facially complying *and* that there are no conditions excusing payment under

§5-114(b). *Id.* at 359. The conditions set forth in §5-114(b) specifically include fraud. The *Delta Brands* court was not confronted with the issue of whether a beneficiary warrants the truth of statements made, and therefore never specifically held, directly or indirectly, that no such warranty exists under §5-111(1). The only other case relied upon by the panel similarly was not confronted with the issue and, therefore, did not conclude that a beneficiary did not warrant the truth of its statements. *See Philadelphia Gear Corp. v. Central Bank*, 717 F.2d 230, 236 (5th Cir. 1983).

It is important to note, however, that in another decision discussed by the panel, Texas' highest court did not interpret the *Delta Brands* decision as does the panel. Indeed, the Texas Supreme Court concluded that, to the contrary:

> All authorities which have addressed the issue agree that under section 5.111(a) a beneficiary warrants that all statements made in documents presented to obtain payment are true. *See Barclay Int'l v. First Alabama Bank*, 557 So.2d 1201, 1206 (Ala. 1989); *Brown v. United States Nat'l Bank*, 220 Neb. 684, 371 N.W.2d 692, 701 (1985); *Pubali Bank v. City Nat'l Bank*, 676 F.2d 1326, 1328-29 (9th Cir. 1982), opinion following remand, 777 F.2d 1340 (9th Cir. 1985); *Mellon Bank v. General Elec. Credit Corp.* 724 F.Supp. 360, 363 (W.D.Pa. 1989); [L.] WEERAMANTRY [& W. SCHLICHTING, IX BANKING LAW] §234.08, at 234-54 to 234-55 [1990]; Dolan, [*Letters of Credit, Article 5 Warranties, Fraud, and the Beneficiary's Certificate*, 41 BUS. LAW. 347,] AT 349 [(1986)]."

Sun Marine Terminals v. Artos Bank & Trust, 797 S.W.2d 7, 11 (Tex. 1990). The foregoing passage was obviously overlooked by the panel.

The panel's decision stands alone as apparently the only reported decision in which it has been held that a beneficiary does *not* warrant the truth of statements made in order to obtain payment under a letter of credit. Because of the far-reaching implications which that holding has for all parties to a letter of credit transaction and because of the less-than-compelling authority upon which it is based, it should be re-examined by the Court *en banc*.

B. The Independence Principle

As mentioned above, the independence principle provides only that an issuer is not free to refuse to honor a conforming draft based upon underlying *contract* disputes between the beneficiary and the account debtor. In the context of this case, it means that Republic would not have been free to refuse to honor Amwest's draft simply because B & F disputed the validity of some of the claims made against the bond. In its opinion the panel attempts to implicate the independence principle by arguing:

> Since *most* assertions of fact required by letters of credit concern performance of the underlying contract between the beneficiary and the customer, allowing the issuer to recover funds paid on a draft because of the falsity of such assertions amounts to allowing the issuer to recover because of non-performance of the underlying contract.

Slip Op. at 11 (emphasis added). Whatever validity as an abstract legal principle this rule may have, it is simply inapplicable in this case.

First, if the court focuses on compliance with *the condition* that the draw not exceed claims made, the rule announced by the panel does not apply because it is addressed to statements and not to conditions. Second, the statement at issue here does not relate to the performance of the underlying contract. The statement warranted was that Amwest deemed the draw to be necessary and, thus, that the draw did not exceed claims made. Whether Amwest "deemed" the draw to be necessary deals strictly with the issue of whether or not Amwest made a determination of necessity and not with whether that determination was in fact justified under the terms of its contract with B&F. Similarly, the performance issues *under the contract* between Amwest and B & F are with respect to whether the claims are valid and deserving of payment under the bond. The *number* of claims made, however, is a fact over which the parties have no control, and the relationship of the size of the draw and the number of claims is strictly an issue of performance under the terms of the letter of credit. As one Court has recognized, "Because [the issuing bank] is suing on the warranties made by the beneficiaries, it is suing on the letters themselves and not on the underlying contract . . . . " *Pubali Bank v. City Nat. Bank*, 777 F.2d 1340, 1343 (9th Cir. 1985).

That the independence principle should not prevent recovery by Republic in this case is also dictated by public policy. As courts have recognized in the past, the

policies underlying the independence principle are outweighed by a stronger public interest in preventing fraud. *Universal Marine Ins. Co.*, 581 F.Supp. at 1139; *Larson*, 603 F.Supp. at 470.

Based upon the foregoing, Republic submits that the independence principle does not provide a sufficient justification for the dramatic rule changes announced in the panel's opinion.

II. REPUBLIC'S RETENTION OF THE DISPUTED FUNDS IS NOT UNJUST.

The panel's opinion, as noted above, begins with the observation that in order for there to have been unjust enrichment, Amwest must have been the owner of the funds at the time Republic gained possession. The sole basis upon which the panel purported to find a right in Amwest to ownership of the funds was its finding that Amwest did not breach its §5-111 warranty. This latter finding was obviously necessitated by the fact that had a breach of warranty been found, the UCC clearly entitles the issuer to possession of the wrongly obtained funds. *See* South Carolina Reporter's Comment to §5-111(1).

The panel held alternatively that even if there had been a breach of warranty, Amwest would be entitled to the funds in order to prevent Republic from receiving a "windfall." This alternative holding overlooks the fact that once a breach of warranty is assumed, the sole basis available to the panel for concluding that the funds belong to Amwest no longer exists. Because a party is entitled to restitution only with respect to property which

belonged to it in the first instance, the "windfall" rationale cannot support restitutionary recovery.

Beyond this logical infirmity in the "windfall" rationale, there is a more important policy reason for rejecting it. In order to find a "windfall," the panel placed itself in the position of having to weigh the equities between issuer and beneficiary, thereby creating precisely the type of uncertainty which letters of credit and related legislation are designed to avoid. As noted by Judge Goldberg, "The terms of letters of credit and applicable laws choreograph an elaborate dance. So long as the steps are followed, payment also follows." *Philadelphia Gear,* 717 F.2d at 241 (dissenting opinion). This elaborate dance requires strict compliance with the terms of the credit. As one commentator explains:

> Properly understood, the rule of strict compliance is vital to the health of the credit. Credits require precision and it is dangerous for courts, unguided by the dictates of commerce, to pick and choose what should be given effect and what should not. When a bank issues a credit, it undertakes a specified risk and no other, and that should be the legal character of its undertaking.

J.E. Byrne, *Letters of Credit,* 43 THE BUSINESS LAWYER 1353, 1359 (1988).

The cases show that once a breach of warranty has been established, the adverse consequences of the breach fall upon the beneficiary. For example, in *Delta Brands,* a case heavily relied upon by the panel, the court held the bank entitled to recover back from the beneficiary the proceeds of the letter of credit due to a mere technical language failure in the draft and even though payment was due the beneficiary for goods sold and delivered. 719

S.W.2d at 359. As between the bank and the beneficiary, it was left to the beneficiary to recover from the account debtor. In this case, Amwest's failure (whether fraud or negligence) is, if anything, more culpable and, thus, less deserving of judicial assistance. Republic has found no cases holding the beneficiary to be entitled to the proceeds of a letter of credit notwithstanding a breach of §5-111 warranties, and the panel's opinion cites none.

Finally, Republic would point out that this is simply not a case of enrichment or windfall.[1] The panel overlooks the fact that Republic's and Amwest's respective positions were the same in the sense that they were both seeking repayment as creditors of B&F. Amwest's breach of warranty merely requires that it, and not Republic, must face the uncertainties of recovery directly against B&F and its guarantors, as opposed to the certainty of payment out of the proceeds of the letter of credit. That is the way it should be, given Amwest's failure to exercise care in this transaction.

III. THE PANEL RELIED UPON IMPROPER GROUNDS.

The panel's decision is premised upon three grounds: (1) that Amwest did not warrant the veracity of its statements, (2) that permitting Republic to retain the funds would conflict with the independence principle, and (3)

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[1] The panel's decision also overlooks the fact that on analogous facts the South Carolina Court of Appeals has held that no unjust enrichment had occured. *Ellis v. Smith Grading & Paving, Inc.*, 366 S.E.2d 12, 15 (S.C.App. 1988).

that judgment in favor of Amwest was authorized, even in the presence of a breach of warranty, in order to prevent Republic from receiving a "windfall." Because none of those grounds was raised by Amwest at trial or on appeal, the panel's published order constitutes the first notice to Republic that said grounds, if not waived, are even part of this case. Having had no adequate opportunity to address the panel's grounds for decision, Republic respectfully submits that in the event rehearing is not granted, it will suffer a denial of procedural due process of law as guaranteed by the Fifth Amendment to the United States Constitution. *See Bass v. Bass*, 249 S.E.2d 905 (S.C. 1978); *Mayhill Homes v. Family Fed. Sav. & Loan*, 324 S.E.2d 340 (S.C.App. 1984).

Conclusion

In summary, Republic believes that the questions decided by the panel are of potentially immense commercial importance. Because of that fact, because of the above infirmities in the panel's reasoning, and because fundamental fairness dictates that Republic have a full and adequate opportunity to challenge that reasoning, Republic respectfully requests a rehearing and suggests that rehearing be conducted *en banc*.

Respectfully submitted,

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October 13, 1992

CERTIFICATE OF SERVICE

I hereby certify that due and proper service of the document affixed hereto and described below was made by depositing two copies of same in the United States Mail at Columbia, South Carolina, in an envelope with adequate first-class postage duly affixed and return address clearly indicated thereon and addressed to:

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PETITION FOR REHEARING AND SUGGESTION FOR REHEARING EN BANC

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